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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1965

No. 28

LOUIS KATCHEN, Petitioner,

VS.

**HYMAN D. LANDY, Trustee in Bankruptcy,
Respondent.**

**In the Matter of
KATCHEN'S BONUS CORNER, INC., Bankrupt.**

**ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR THE TENTH CIRCUIT**

BRIEF FOR RESPONDENT

STATEMENT OF THE CASE:

Factual questions are substantially uncontested for purpose of the present proceeding, which involves essentially a legal problem relating to the summary jurisdiction in bankruptcy, and a constitutional question as to the function of and right to jury trial as related thereto.

Bankrupt corporation began business in April, 1960, with the Petitioner as a vice president, director, and stock-

holder, his two sons and a third person being the other stockholders and directors. Stock subscriptions were entered by Petitioner and others, but the subscriptions were not paid.

In April, 1960, bankrupt borrowed \$40,000.00 from American National Bank, and gave a note for that amount, upon which Petitioner asserts he was an accommodation maker. In June, 1960, bankrupt borrowed \$10,000.00 from North Denver Bank, which note bore the typescript name of the bankrupt and the signature of the Petitioner and two other stockholders without further designation or description. Petitioner claims he is neither an accommodation maker nor personally liable on the latter \$10,000.00 note. Referee and Trial Court found otherwise.

In August, 1960, bankrupt sustained a fire loss. Thereafter collections of the bankrupt were placed in a so-called trust account under the sole control of the Petitioner, who from that account paid on October 13, 1960, \$14,599.00 and on November 18, 1960, \$10,137.50 on the \$40,000.00 note to American National Bank. It is admitted by the Petitioner that those payments reduced his personal liability, and that he knew such was the case when he made the payments.

In September, 1960, Petitioner paid \$10,162.50 to the North Denver Bank on the \$10,000.00 note mentioned.

Petitioner filed in the bankruptcy proceedings two claims, one for \$4,625.00 for unpaid rent on premises he owned and which were occupied by the bankrupt, and one for \$5,000.00 representing payment from personal funds of Petitioner to the American National Bank on the note above described.

The Trustee asserted, in the nature of counterclaims to the claims filed by the Petitioner, three counterclaims for the recovery of preferences predicated upon the three payments to the banks upon the loans mentioned above, and an additional counterclaim predicated upon failure to make payment upon the stock subscription mentioned above.

The Referee found that payment of the corporate funds from the trust account on the several bank notes constituted preferences received by the Petitioners, and it was ordered that these be repaid. The Referee further ordered payment of \$10,000.00 as unpaid stock subscription.

The District Court sustained the Referee.

The Circuit Court sustained the judgment below as to the three preferential counterclaims, and reversed as to the \$10,000.00 stock subscription, holding that the latter claim does not appear to arise out of the same transaction on which the claim is based.

The Trial Court acted substantially on the authority of *Inter-State National Bank of Kansas City vs. Luther, Trustee*, 221 F.2d 382, cert. granted 350 U. S. 810, cert. dismissed by stipulation of parties, *id.*, 944.

The Circuit Court, sitting en banc, divided upon the question of the allowance, in summary proceedings, of the three preference counterclaims.

Petitioner claims that the Referee in Bankruptcy is without power, a claim having been voluntarily filed by the Petitioner, to exercise summary jurisdiction over counterclaims arising out of the same transaction, where

the claimant objects to summary jurisdiction, and appears to contend that such counterclaims must be separately adjudicated in a plenary action instituted by the Trustee.

Petitioner asserts that the Act of Congress does not grant authority to exercise the summary jurisdiction over such counterclaims, and that the Seventh Amendment, relating to trial by jury, precludes such jurisdiction.

Only these jurisdictional, procedural, and constitutional questions, are here presented to the Court. No substantive question as to liability upon the several claims is before this Court.

SUMMARY OF ARGUMENT:

1. Whatever may have been the law prior to the announcement by this Court of its decision in *Alexander vs. Hillman*, 296 U.S. 222, 56 S.Ct. 204, 80 L.Ed. 192 (1935), it was held in that case that a claimant who filed claims with an equity receiver, but who had not been served with process, nonetheless subjected himself to the jurisdiction of the district court in which receivership is pending for purposes of counterclaims based on alleged misappropriations, since the subject matter of the counterclaims, being cognizable in equity, the district court might grant full relief.

2. Jurisdiction in bankruptcy involves equitable jurisdiction, and those doctrines relating to preferential treatment as among creditors are essentially equitable doctrines, and derive as well from the essential statutory powers of bankruptcy courts in distribution among creditors, in which process a single adjudicatory authority, the

Referee, must be able to make a full determination of rights and liabilities within the over-all canopy of the Bankruptcy Act, applying each of its standards, including the requirements of and with the processes provided by 57(g).

3. Accordingly, since announcement of *Hillman*, its reasoning has been broadly applied in bankruptcy, to the end that it has been held by a majority of the Circuits that an unsecured creditor who files proof of claim submits himself to the jurisdiction of the bankruptcy court for the purposes of a counterclaim arising out of matters arising between the claimant and the bankrupt and asserted by the receiver or trustee.

4. Some division of authority has appeared with reference to counterclaims which do not arise out of the same transaction upon which the claim is based. Since, however, the three allowed counterclaims do unquestionably arise out of the same transaction, this proceeding does not directly involve that distinction or question.

5. Bankruptcy authorities generally have approved the indicated development of the law upon the bases that (a) "equity once invoked will achieve complete relief", and further (b) that "sound construction of the Bankruptcy Act warrants complete adjudication". If, indeed, complete adjudication cannot be had upon a claim by the Referee as the authority charged with the duty to adjudicate the claim, then bankruptcy jurisdiction and the important functions purposed to be achieved thereby are materially prejudiced.

6. Adjudication of counterclaims derivative from the subject matter of a claim filed before the Referee in no

manner interferes with the Seventh Amendment guaranty of jury trial. The Amendment provides that "in suits at *common law*, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved." Bankruptcy jurisdiction is *not common law jurisdiction*, and claims filed in bankruptcy are not suits at common law.

7. The power to legislate on the subject of bankruptcies is expressly conferred upon Congress by the Constitution, Article I, Section 8, Clause 4, providing that Congress shall have the power "to establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." It is deemed that the language was used advisedly, and conferred upon Congress the power to legislate on the whole "subject of bankruptcies", embracing all phases of the relationship between a debtor financially embarrassed and all his creditors.

8. Bankruptcy is not in the category of "suits at common law". In essence, bankruptcy law is inconsistent with the settled principles of common law permitting the creditor first seizing assets by execution or attachment to realize over others. Proceedings in bankruptcy are generally conducted in accordance with equitable principles. Bankruptcy jurisdiction, however, is not even solely equity, but is at base a distinct and specialized branch of law, jurisdiction, and jurisprudence, to which the Amendment Seven guarantee, in terms applicable only to "suits at common law", does not apply.

ARGUMENT

A. SINCE ALEXANDER VS. HILLMAN, IT HAS GENERALLY BEEN HELD THAT SINCE COUNTERCLAIMS, LIKE CLAIMS, ARE COGNIZABLE IN EQUITY, THE BANKRUPTCY COURT MAY GRANT AFFIRMATIVE RELIEF UPON A COUNTERCLAIM ASERTED RESPONSIVE TO A CLAIM IN BANKRUPTCY VOLUNTARILY FILED.

Some discussion is devoted in the Brief of the Appellants to the case of *Alexander vs. Hillman*, (1935), 296 U.S. 222, 56 S.Ct. 204, 80 L.Ed. 192. The view is expressed in that Brief that the doctrine of the case is one primarily relating to venue, and is of minimal significance with relation to the substantive problem involved at bar. It is submitted, however, that the doctrines of Alexander vs. Hillman are basic to consideration of the questions here presented.

Prior to that case, there existed some law to the effect that, though a bankruptcy court could consider defenses to claims filed against the estate of the bankrupt, and indeed was authorized and had jurisdiction to set off any claims of the bankrupt estate against the claimant, up to the total amount of the claims filed against the estate by that claimant, the Bankruptcy court was without jurisdiction to render an affirmative judgment against the claimant, unless the claimant consented to jurisdiction.

Among the cases which are sometimes cited to that effect are *Bardes vs. First National Bank of Hawarden*, 1900, 178 U.S. 524, 20 S.Ct. 1000, 44 L.Ed. 1175; *In Re Carl Dernburg & Son, Inc.*, (CCA2d, 1924) 5 F.2d 37;

Fitch vs. Richardson, (CCA1st, 1906) 147 Fed. 197; and *In Re Patterson-MacDonald Shipbuilding Co.*, (D.C., W. D. Wash., 1922), 284 Fed. 281. Indeed, *Bardes vs. Hawarden* is cited in this context in the Brief of the Appellant, as controlling in the action at bar.

Alexander vs. Hillman permits of no such interpretation. The case did not directly involve bankruptcy. In it, however, the Supreme Court held that the former officers of a corporation in receivership, which former officers had filed claims with the equity receiver, but who had not been in any manner served with process in the receivership proceeding, by the filing of those claims subjected themselves to the jurisdiction of the district court for the purpose of the adjudication and determination and entry of judgment upon counterclaims based on their, the claimant officers', alleged misappropriations from the corporation in receivership. This Court specifically noted that since the subject matter of the counterclaims, like that of the claims themselves, was cognizable in equity, the District Court had jurisdiction to grant affirmative relief.

In *Alexander vs. Hillman*, it was asserted by the Claimant officers first that a statute providing that no civil suit be brought in any District Court against any person by any original process in any district other than the district whereof the person so sued is an inhabitant does not affect the general jurisdiction of the District Courts, but merely confers a personal privilege which may be waived, and that a nonresident who presented a claim in the receivership proceeding against the receiver did so waive the privilege and subjected themselves to all the consequences attaching to a general appearance.

The claimants then asserted the provisions of Equity Rule 30, to the effect that they had by their filing of claims commenced suit, so that the defendant (i.e., the receivers) must by their answer set out their defenses to each claim in the bill, and the answer must state any counterclaim arising out of the transaction which is the subject matter of the suit, and might set up any set-off or counterclaim which might be the subject-matter of independent suit. The Court held that this did not preclude the presentation of the counterclaims by ancillary bill; that "The rule does not purport to cover, and was not prescribed for, situations such as that here presented."

Nearly an identical kind of reasoning inheres in the Appellants' assertion in the Brief that "no Act of Congress grants to a Referee in bankruptcy the power to exercise summary jurisdiction over a counterclaim by the Trustee against a Claimant where the Claimant objects to summary jurisdiction."

Appellant cites, and prints in his Appendix A, Section 2(a)(7) of the Bankruptcy Act, 11, U.S.C. 11(a)(7). That section is a very broad grant of power, whereunder "the Courts of the United States *** are hereby invested *** with such jurisdiction *** to cause the estate of bankrupt to be collected, reduced to money, and distributed, and determine controversies in relation thereto, except as herein otherwise provided, and determine and liquidate all inchoate or vested interests of the bankrupt's spouse in the property of any estate, whenever, under the applicable laws of the State, creditors are empowered to compel such spouse to accept a money satisfaction for such interest; ***".

By that section, it is further provided that "where in a controversy arising in a proceeding under this title an adverse party does not interpose objection to the summary jurisdiction of the court of bankruptcy, by answer or motion filed before the expiration of the time prescribed by law or rule of court or fixed or extended by order of court for the filing of an answer to the petition, motion or other pleading to which he is adverse, he shall be deemed to have consented to such jurisdiction."

From this, Appellant argues that in a case where the jurisdiction is *affirmatively sought* by the claimant, as by Appellant at bar, the person so seeking jurisdiction may interpose objection, not to the jurisdiction he has sought, but precluding jurisdiction to render judgment against him. This is a highly strained interpretation. Jurisdiction of the District Court in bankruptcy extends to "determining controversies" in relation to the bankruptcy. Bankruptcies, like coins, possess an obverse and reverse. They are not "determined" by examination of one side only. To "determine" a controversy means finally to adjudicate upon and place a termination or end to it. If one is ordered in by summary process to a bankruptcy court, one may interpose timely objection to jurisdiction. If one voluntarily comes in and seeks jurisdiction, one cannot then say, having sought it, that he interposes objection to the pendular swing against him.

In rejecting the arguments made by the Claimants with reference to Equity Rule 30, this Court said:

"But the omission so to extend the rule gives rise to no implication that receivers may not assert and enforce, against those who appear and demand part of the res,

counterclaims for portions of the receivership estate that they wrongfully took and still withhold. The right of the receivers to have affirmative relief in the receivership court is supported by the same, or at least similar and equally strong, reasons as those that constitute the foundation of the rule." [240]

Where the statute confers explicit jurisdiction to "determine controversies in relation" to the estate of the bankrupt; where the summary jurisdiction is expressly conferred "where an adverse party does not interpose objection" in the manner prescribed; and where the jurisdiction is sought, as here, not by the trustee asserting a claim, but by the Claimant voluntarily coming in, then certainly there is not the least implication that the subordinate clause in any manner militates against or derogates from the ordinary rule that assertion of a claim necessarily presupposes jurisdiction to determine and fully adjudicate counterclaims connected therewith and arising therefrom.

Any other result leads to a palpable absurdity, and to a traduction of the essential purpose of the Bankruptcy Act, making quite germane the substantive comment of this Court in *Alexander vs. Hillman* [241]:

"Respondents' contention means that, while invoking the court's jurisdiction to establish their right to participate in the distribution, they may deny its power to require them to account for what they misappropriated. In behalf of creditors and stockholders, the receivers reasonably may insist that, before taking aught, respondents may by the receivership court be required to make restitution. That requirement is in

harmony with the rule generally followed by courts of equity that, having jurisdiction of the parties to controversies brought before them, they will decide all matters in dispute and decree complete relief. [Citing authorities]. Distribution may not be made without decision upon the counterclaims. Nothing is more clearly a part of the subject-matter of the main suit than recovery of all that to the res belongs. [Citing authorities]."

While *Alexander vs. Hillman* did not upon its face relate to a bankruptcy proceeding—albeit a receivership matter bears a close cognacy—the reasoning of *Hillman* was thereafter applied to Bankruptcy cases.

Hillman originally came up from, and reverses a contrary decision of, the Fourth Circuit, which, appropriately, was the first of the Circuits to recognize the applicability of the rule to Bankruptcy, and to apply it, doing so in *Florance vs. Kresge* (CCA 4th, 1938) 93 F.2d 784. It was there held that an unsecured creditor who had filed a claim submitted himself thereby to the jurisdiction of the bankruptcy court for the purposes of a counterclaim arising out of a contract between claimant and the bankrupt, and asserted by the receiver and trustee. The statement of the Rule is clear and precise [786]:

"We agree with the learned District Judge that the court below had jurisdiction to adjudicate the rights of the parties with respect to the claims asserted by the receivers and trustee against Kresge. The latter had made himself a party to the cause, both by filing an unsecured claim with the referee and by filing an intervening petition with the court asking that moneys in the hands of the receivers be turned over to him.

Both claims related to his contract with bankrupt for the subletting of the property; and the claims asserted by the trustee and receivers were counterclaims arising out of the same contract. We see no reason why the court of bankruptcy should not pass upon the claims in favor of the bankrupt estate and set them off against the claims filed against the estate and its receivers; and, under the recent decision of the Supreme Court in *Alexander vs. Hillman* * * *, we see no reason why the court, *which is a court of equity even though exercising special statutory powers*, (emphasis supplied), should not proceed to render judgment against Kresge for any balance found to be due by him. In the case cited, the Supreme Court reversed a decision of this Court which denied the jurisdiction of a court of equity to grant affirmative relief on a counterclaim against a claimant who had filed a claim with the equity receivers, saying:

“‘Respondents appropriately presented their claims and became entitled to adjudication without petition for intervention, any formal pleading, or commencement of suit. Unquestionably, they submitted themselves to the court’s jurisdiction in respect of all defenses that might be made by the receivers and of all objections that other claimants might interpose to the validity, amounts, or priorities of their claims. And they put themselves in position, should their interests warrant, to challenge the receivers’ acts and the demands of others claiming as creditors. * * * The Circuit Court of Appeals rightly held that the District Court has jurisdiction to pass on all defenses against respondents’ claims, but erred in holding it to be without jurisdiction to grant affirmative relief.’”

The argument of Petitioner with relation to the absence of an Act of Congress conferring jurisdiction simply overlooks the essence of filing of a claim. By that act, which is entirely volitional on the part of the Claimant, and optional with him alone, the claimant, as stated in *Florance vs. Kresge*, "had made himself a *party* to the cause". As this Court said in *Hillman*, by so doing, filing claim, the claimants "put themselves in position, should their interests warrant, to challenge the receivers' acts and the demands of others claiming as creditors." While it is perfectly true that a person brought involuntarily into the summary orbit of bankruptcy jurisdiction, by the act of another, as by the petition of the Trustee and the like, may not be required to remain therein, but may elect to have trial in a plenary proceeding, Claimants in bankruptcy, who appear by their own volitional act, cannot thereafter disclaim as to the jurisdiction against them, for by filing claim they become *parties*, a status having dual result, benefit and responsibility.

This Court in *Hillman* specifically reversed the Fourth Circuit because the Circuit had held that affirmative relief could not be granted on the counterclaim. This Court held that the Fourth Circuit "erred in holding it to be without jurisdiction to grant affirmative relief" upon the counterclaim. That is the very essence of the pending litigation. It is the essence of *Hillman* and all that follows it.

B. SINCE THE ANNOUNCEMENT OF HILLMAN, JURISDICTION IN BANKRUPTCY INVOLVING EQUITABLE JURISDICTION, THE REASONING OF HILLMAN HAS BEEN BROADLY APPLIED IN THE CIRCUITS TO THE EFFECT THAT AFFIRMATIVE RELIEF MAY BE GRANTED UPON COUNTERCLAIM ASSERTED AGAINST A CLAIMANT WHO SUBMITS HIMSELF TO JURISDICTION OF THE BANKRUPTCY COURT BY THE ACT OF FILING A CLAIM.

The basic rule having been announced in *Hillman*, and applied, as indicated above, in *Florance vs. Kresge*, to bankruptcy proceedings, the Circuits have rather broadly held, following the reasoning of *Hillman*, that an unsecured creditor who files proof of claim submits himself to the jurisdiction of the bankruptcy court for the purpose of a counterclaim arising out of matters arising between the claimant and the bankrupt and asserted by the receiver or trustee.

Those Circuits so holding have applied the rule in cases, and under circumstances, as follow:

1. IN THE FOURTH CIRCUIT:

The rule in *Hillman* arose out of review of a decision of the Fourth Circuit, and the application of the *Hillman* principle in bankruptcy cases was first made by that Circuit in *Florance vs. Kresge, supra*. Since that time, the rule has been perhaps more extensively discussed in the Fourth Circuit than elsewhere, though the Rule is followed by cases, discussed below, in the Second, Third,

Eighth, Ninth, and Tenth Circuits as well, a majority of the Circuits presently adhering to it.

Columbia Foundry Company vs. Lochner, Trustee (CCA 4, 1950) 179 F.2d 630, 14 ALR 2d 1349, involved the filing, in a bankruptcy proceeding, of a claim for the purchase price of certain cast iron castings sold the bankrupt. Claim was filed by mail by a nonresident creditor, who executed to local attorneys power of attorney to vote at creditor's meetings. Trustee excepted to the claim on the ground of defectiveness of the castings, and also asserted a very large counterclaim for damages allegedly resulting from the use of the defective castings in the business of the bankrupt and, as contended by the Trustee, actually resulting in the bankruptcy itself.

Claimant sought dismissal of the counterclaim, insofar as it exceeded the claim in bankruptcy filed by the Claimant on the ground that the Bankruptcy Court lacked jurisdiction both of the Claimant and the subject matter of the counterclaim. Order of the Referee, affirmed by the District Court, denied dismissal, and the Fourth Circuit sustained that position.

In doing so, the Fourth Circuit limited its discussion to counterclaims relating to the same subject matter as the claim itself, and held, with relation to that class and kind of counterclaim, that the bankruptcy court had jurisdiction to enter affirmative judgment for the trustee on the counterclaim, notwithstanding a provision in the Bankruptcy Act which required action by the Trustee to be brought in the district of which the defendant is an inhabitant.

In deciding that the Claimant voluntarily filing in

Bankruptcy voluntarily made himself a *party* for all purposes to the bankruptcy proceeding, the Court referred, as in *Florance vs. Kresge, supra*, to *Hillman*, quoting the same portions thereof set forth in the quotation from *Florance vs. Kresge* above, and further quotes *Hillman*:

"The rule contained in Section 41, Judicial Code, 28 USC, #112 [28 USCA #112], that is invoked by respondents here declare: 'No civil suit shall be brought in any district court against any person by any original process or proceeding in any other district than that whereof he is an inhabitant.' The section applies only where a suit is 'brought . . . by any original process or proceeding.' No attempt was made to summon respondents into court. That provision does not affect the general jurisdiction of the District Courts, but merely confers a personal privilege that may be waived . . . [Citations] . . . By presenting their claims respondents subjected themselves to all the consequences that attach to an appearance, section 51 to the contrary notwithstanding . . . [Citations] . . . "

The Fourth Circuit referred to its own opinion in *Florance vs. Kresge, supra*, and cited, as approving that position in respect to the filing of proofs of claim in bankruptcy as consent to the jurisdiction of the court, *Collier on Bankruptcy*, 14th Ed., Vol. 4, Sec. 6820, pp. 788-790, language which we will cite below, and which, it is to be noted, was cited in the decision of the Tenth Circuit, sought to be reviewed herein, and quoted *in extenso* by Chief Judge Murrah in his Opinion [Record, pages 10 and 11, Note 1].

It is obviously an essential of bankruptcy administration that, insofar as jurisdictionally possible, the affairs

of the bankrupt be, by one tribunal, administered and fully adjudicated, in an orderly fashion. The decision in *Lochner* so recognizes:

"A case of this sort demonstrates the wisdom of the rule laid down in *Florance vs. Kresge*, *supra*, and the improbability that Congress intended to restrict the use of counterclaims to defensive purposes only. Here the trustee is called upon to pay for goods sold to the bankrupt which, for the purposes of the argument, must be assumed to have been so defective as to cause the bankrupt a loss greatly in excess of the purchase price of the merchandise. The counterclaim relates to the very subject matter of the claim itself. It is conceded that the trustee may prove the counterclaim so as to defeat the claim and it follows that the creditor must produce the same evidence to save his claim as he would to defeat an affirmative judgment against him on the counterclaim. The inconvenience and expense of transporting witnesses and records from the claimant's home office to the bankruptcy court, which is stressed by the appellant, would be the same in either event; and the difficulty is unavoidable since it is essential that claims against an insolvent in bankruptcy as in an equity receivership must be handled by the court in charge of the debtor's estate. * * * "

Each of the contentions of the Petitioner here as to the meaning of the Bankruptcy Act, and his assertion that there is no act of Congress allowing affirmative relief in the assertion of a counterclaim, is rather strongly and clearly answered by the Fourth Circuit as placing too strong an emphasis between the venue provisions [at bar the subsidiary clause of the statute on election for plenary hearing] and the basic right of the Trustee to avail him-

self of set-offs and counterclaims where the creditor presents the claim against the estate and is the moving party, invoking jurisdiction:

"It seems clear that in adjusting the apparent conflict between Section 23, 11 USCA #46, and Section 68, 11 USCA #108, of the Bankruptcy Act, too much emphasis has heretofore been placed upon the requirements of Section 23 that suits by the trustee shall be brought only where the bankrupt might have brought them if bankruptcy had not occurred, that is, in the district whereof the defendant is an inhabitant, and too little weight has been given to the right of the trustee under Section 68 to avail himself of set-offs and counterclaims, where a creditor presents a claim against the estate. The purpose of Section 23 to protect a defendant from the expense and inconvenience of defending a suit by the trustee away from his home is clear, and this purpose can be served by compelling a trustee who desires to sue to bring the action in the defendant's district. In this way Section 23 can be given adequate scope, since it applies only when the trustee brings suit; and there is no good reason to extend it to the situation where the Trustee himself is sued in effect in the bankruptcy court by a creditor who files a claim against the estate. Then Section 68, entitled 'Set-offs and counterclaims' comes into play, and it is required that an account of mutual debts or mutual credits between the estate and the creditor shall be stated and one debt shall be set off against the other and the balance only shall be allowed or paid. There is nought in the text of the section which manifests an intention to subject the trustee to any restriction in the use of a set off that would not

have applied to the bankrupt if sued before his adjudication; and since in such an event the bankrupt could have had an affirmative judgment against his adversary under the ordinary rules of procedure, the trustee should be entitled to the same advantage in winding up the estate. The creditor would not be injured thereby, since the burden of opposing the counterclaim is the same whether it is used as an offensive or defensive weapon, and both parties are advantaged by disposing of both claims in a single suit."

As the Court points out, it stated the objections to this point of view as strongly as possible in its own decision reversed by *Hillman*, and reversed, because as said by this Court, "It is clear that, under the circumstances disclosed, the restrictions laid by the Circuit Court of Appeals upon the receivership court are not consistent with that freedom as to procedure that necessarily belongs to courts of equity administering receiverships."

Of importance, also, is the discussion by the Court of the question of the "right" to a jury in proceedings such as the involved counterclaims in these actions, and its holding that the jury is not, in such circumstances, a matter of right, which discussion, however, is set forth below.

Continental Casualty Company vs. White, Trustee (CCA 4th, 1959) 269 F.2d 213, involved the bankruptcy of a contractor. Contractor's surety filed a claim, and the trustee interposed a cross-claim. Referee refused a motion of the surety to dismiss the cross-claim, and was sustained by the District Court. Sustaining Referee and District Court, the Fourth Circuit held that where the contractor,

being in financial stringency, executed a trust instrument assigning all monies to become due to him on construction contracts to the trustee for the benefit of the surety, the surety agreeing to provide funds for the contractor to complete work on the contracts, and where the sums received by the contractor under the indenture were so closely related to the funds expended by the contractor under the terms of the same instrument as to be inseparable, then the claim of the surety in bankruptcy for the funds provided, and the cross-claim of the Trustee in bankruptcy against the surety, on the theory of voidable preference, for funds paid by the contractor to the surety, arose out of the same transaction. Accordingly, since the matters did arise out of the same transaction, the Circuit Court held that the surety by the filing of its claim submitted itself to the summary jurisdiction of the bankruptcy court in relation to the trustee's counterclaim, which should not be dismissed.

The situation factually is very much that at bar. Discussing its own *Kresge* and *Lochner* decisions above, the Court states that "the law is well settled in this Circuit that a creditor who voluntarily files a claim in bankruptcy submits to the summary jurisdiction of the court in respect to a counterclaim asserted by the trustee which arises out of the same transaction as the claim itself, and the court of bankruptcy has power not only to adjudicate the counterclaim but also to enter an affirmative judgment against the creditor."

Discussing the substance of the claims, the Court arrives at the conclusion that the claims do arise out of the same transaction, and that, "concluding, as we do, that the claim and the counterclaim in this case arise out of

the same transaction, we need not decide whether the bankruptcy court would have summary jurisdiction to adjudicate a cross-claim coming out of a transaction unrelated to that upon which the creditor's claim is based." Of course, it is admitted in the case at bar that Petitioner's Claims and the allowed Counterclaims do arise out of the same transactions, since the Claims involve payments on loans, and the preference counterclaims involve payments on the same loans, relieving the personal liability thereon of the Petitioner. For this reason, and as stated above, we do not discuss here, either, the problem of the counter-claim substantively unrelated to the Creditor's claims upon which jurisdiction is predicated, and where no such relation existed, the Tenth Circuit, in the decision here sought to be reviewed, in fact disallowed jurisdiction of the bankruptcy court.

It is of importance to note that the surety contended *Lochner and Kresge* decisions to have been superseded by a 1952 amendment to the Bankruptcy Act, being the section on timely interposition of objection, quoted and referred above, that is, Section 2., sub. a(7), 11 USCA #11, sub. a(7).

As we have discussed academically above, that Amendment was neither purposed nor effective to permit a claimant to file a claim, and file an objection when counterclaim was asserted against him, he having first and of his own volition invoked the summary jurisdiction in bankruptcy [215-216]:

“ * * * [statute quoted] For a proper interpretation of this statute it is necessary to consider its history. In *Cline vs. Kaplan*, 1944, 323 U.S. 97, 65 S.Ct. 155, 89 L.Ed. 97, the Trustee in Bankruptcy petitioned the

Referee to order the respondents to turn over certain assets allegedly belonging to the bankrupt. The respondents contested the order, claiming ownership in themselves, and near the close of the hearing moved that the trustee's petition be dismissed for want of summary jurisdiction in the bankruptcy court. The Supreme Court held that the turnover order could be resisted as the respondents had not consented to the summary jurisdiction of the Court.

"The section quoted above was enacted to clarify and limit the effect of the Cline case. House Rep. No. 2320 and Senate Rep. No. 2234, 82nd Cong., 2nd Sess. We are of the opinion that this amendment was intended by Congress to apply to situations similar to *Cline vs. Kaplan*, where the adverse party is involuntarily brought into court by peremptory process [Emphasis Supplied], such as a turnover order, and was not meant to diminish the jurisdiction of the bankruptcy court where the creditor has come into court voluntarily by the filing of a claim against the estate. *Interstate National Bank of Kansas City vs. Luther*, 10 Cir., 1955, 221 F.2d 382, 388. There is nothing to indicate that the statute was designed to authorise a party to object to the summary jurisdiction where he has come into court on his own motion seeking relief." [Emphasis Supplied].

Nortex Trading Corp. vs. Newfield, Trustee (CCA 4th, 1962) 311 F.2d 163 involved a claim by Nortex, and a counterclaim filed by the Trustee, and contained in a pleading served upon the counsel for the Claimant. Certain problems as to service were discussed, including a holding that service of a pleading containing the counterclaim may

be made upon claimant's attorney , and need not be personally served upon the claimant. Insofar as pertinent to the discussions at bar, the case restates the Rule announced above [164]:

"The filing by Nortex of its proof of claim is analogous to the commencement of an action within the bankruptcy proceeding. * * * The trustee's petition is in the nature of an answer incorporating an affirmative re-question for relief by way of surrender of the preference. It has often been recognized that counter-claims by the trustee against a claimant are within the summary jurisdiction of the bankruptcy court . . . [Citations] . . . The claimant is deemed to consent to the jurisdiction of the court upon filing its proof of claim. * * * "

2. IN THE SECOND CIRCUIT.

The Second Circuit early recognized the basic and general applicability of the doctrine of this Court in *Hillman*, and discussed the problem in *Chase Nat. Bank of City of New York vs. Lyfrod* (CCA 2nd, 1945) 147 F.2d 273, a Bankruptcy proceeding involving the reorganization of a railroad. It was held that in such a proceeding, a claimant bank which had set off the debtor's account in the bank against the indebtedness and filled in the reorganization proceeding a claim for the balance could not object to summary proceedings, since the presentation of the claim presented to the bankruptcy court the question of the propriety of the bank's action in setting off the account balances against the claim. Judge Frank, for the Circuit, quoted the Supreme Court's statement in *Hillman* that "By presenting their claims respondents subjected

themselves to all the consequences that attach to an appearance, section 51 to the contrary notwithstanding.'

Applying that rule in reference to a claim in bankruptcy, he stated further [277]: "We think that the doctrine of that case is not limited to a case where claims are filed by wrongdoing officers and directors (or the like). And we see no reason why the doctrine is not applicable to proceedings under section 77, no reason why the venue provisions of section 23 were not waived when the bank filed its claim against the debtor here."

Further, said the Court, "here the very claim of the bank, since it disclosed the application of the balance and was for the net amount remaining after such application, presented to the court the issue of the validity of the bank's conduct in applying the balance," as, indeed, the claims of the Petitioner, liable upon the notes, in applying the trust or sequestered funds in his hands and sole control to the liquidation of debts upon which he has a liability, and with respect to payments on which he makes a claim, clearly must submit the question of propriety of the use of the sequestered funds, so far as the rules of preference are concerned.

In *Conway et al. vs. Union Bank of Switzerland et al.*, (CCA 2nd, 1953) 204 F.2d 603, certain Swiss banks filed a bankruptcy claim, but did not properly proceed to perfect it. An order had entered which required doing of certain acts by the claimant by a certain date, or that they be barred from the distribution of assets. It was held by the Circuit that such an order, not complied with, did not amount only to a grant of leave to withdraw with reservation in the trustees of the right to file a counterclaim, but

finally terminated the claims of the bank as much as would have been done had their claim been dismissed, so that the court had no jurisdiction over the banks thereafter, and accordingly none over counterclaims asserted against them.

However, the *Hillman Rule* was very specifically recognized and concurred in, and it was held that the banks which had made a claim had thereby made themselves parties to the Bankruptcy proceedings, that by so claiming, the creditor was exposed to every defense that the insolvent might have to the claim, including set-offs or counterclaims, and that it is immaterial whether the creditor's claim is valid, the only relative inquiry being whether or not he is a claimant when the counterclaim is filed.

It was held in that regard that the banks were not claimants when the counterclaims were filed because for all effective purposes their claims had been dismissed and they were no longer before the bankruptcy court, although they had once been so. Judge Learned Hand for the Circuit stated the matter as follows [606-607]:

"We agree with the Trustee that 'The Banks' had made themselves parties to the reorganization proceeding. Indeed, we cannot see what more was necessary than the claim they had made in 1946 to the dividend of ten per cent, and the receipt of \$64,000 by the Central Bank. There can be no more definitive act making one a party to a proceeding to distribute the assets of an insolvent among its creditors, than to claim and actually to receive one's proportional share in a distribution of its assets. That is precisely the

purpose of such a proceeding and all that any creditor can get out of it. * * *

"As we have already said, the only interest of a creditor or shareholder in an insolvency proceeding is to recover his share of the assets, but by intervening he naturally exposes himself to every defense that the insolvent may have to his claim, including set-offs or counterclaims; however uncertain it was before the Supreme Court so held in 1935 whether he also exposed himself, not only to an extinction of his claim, but also to affirmative recovery under a counterclaim.⁵ [5. Alexander vs. Hillman, 296 U.S. 222, 56 S.Ct. 204, 80 L.Ed. 192]. That case did so decide, and we assume therefor that the notices served under the Trustee's Petition of December 27, 1951 would have been an equivalent of personal serve upon 'The Banks,' if at that time they had been claimants, as creditors of the Debtor; but we think that they had ceased to be such claimants before the Trustee's petition of December 27, 1951, was filed, and that it was no longer possible to obtain jurisdiction *in personam* over them. * * * "

Again, there seems to be unequivocal acquiescence by the Second Circuit in the interpretation of *Hillman* as holding that a claimant in a bankruptcy proceeding exposes himself to counterclaims not only extinguishing his claim, but to affirmative recovery under the counterclaim.

3. IN THE THIRD CIRCUIT.

In *Re Solar Manufacturing Corporation*, (CCA 3rd, 1952) 200 F.2d 327 involved the filing by indenture trustees of claims in bankruptcy under agreement with the debtor. Counterclaims were filed by the Trustees in Bankruptcy

against the claimant, which moved to dismiss on jurisdictional grounds. The Third Circuit held that the District Court, as the bankruptcy court, had summary jurisdiction over such counterclaims.

The Court carefully discussed all of the decisions mentioned herein and made to the date of its own decision, and concluded that while prior to *Hillman* it had been held that a bankruptcy court could consider defenses to claims filed against the bankrupt estate and was empowered to set off claims of the estate against the claimant up to the amount of the claim, after affirmative judgment could be granted on the counterclaims, since in *Hillman* "the court noted that since the subject matter of the counterclaims, like the claims, was cognizable in equity the district court had jurisdiction to grant affirmative relief."

The Court notes that "the reasoning of *Hillman* was thereafter applied in bankruptcy cases," and in this connection discusses *Florance vs. Kresge and Columbia Foundry vs. Lochner, supra*.

Additionally, the Court, noting that its facts were "quite similar to those before us" discussed *In Re Nathan*, (D.C.S.D. Cal., 1951), 98 F.Supp. 686, and discussed the reasons for allowance of full adjudication and rendition of judgment upon counterclaims, under the summary jurisdiction [330]:

" * * * An adjudication of the defenses and set-off to the claim would be res judicata in a plenary suit on the counterclaim. Thus the legal result of allowing a plenary suit on the counterclaim would be the same as if consent to summary jurisdiction had been given. Second: A fundamental purpose of the Bankruptcy

Act is to effect a quick and summary disposal of questions arising in the progress of the case. The court pointed out that those considerations of reason and policy which were strong factors in the Hillman decision were equally applicable in the Nathan Case. It held that implied consent to the jurisdiction of the Bankruptcy Court had been given by the creditor when it filed its claim; that no substantial right of the creditor was therein impinged and that the result would be to effectually speed up the final settlement and distribution of the bankrupt estate in accordance with one of the distinct purposes of the Bankruptcy Act."

The Third Circuit in this opinion, as did the Fourth Circuit in *Florance vs. Kresge*, and Judge Murrah in the Tenth Circuit Opinion in the case at bar, notes the concurrence, as a matter of expedition of the essential bankruptcy jurisdiction, of Collier on Bankruptcy in the view so expressed. [Vol. 4, pp. 788-90].

The Third Circuit therefore concluded that filing of the claim conferred jurisdiction to grant affirmative relief upon counterclaim arising out of the same subject matter, stating [331]:

"In Hillman, Kresge, Lochner and Nathan, as in this appeal, the subject matter of the counterclaim arose out of the same transaction as the claim. This is important because in those circumstances, as we have above indicated, the trustee may have a summary adjudication of the issues upon which his counterclaim depends by raising these issues in his answer to the claim. Appellant offers no reason for compelling the trustee to institute a plenary action in order to obtain

affirmative relief where as here, the issues adjudicated as defenses on the claim would be res judicata in the plenary suit."

4. IN THE EIGHTH CIRCUIT.

Floro Realty & Investment Co. vs. Steem Electric Corporation, et al., (CCA. 8th, 1942) 128 F.2d 338, involved a bankruptcy situation in which the lessor of the bankrupt asserted in the bankruptcy court a claim for the possession of the premises leased to the bankrupt, as a result of which there was asserted a claim against that claimant for the return to the lessee and its successors of a deposit made with the lessor to secure the payment of rent under the lease. It was claimed by the lessor that there was no jurisdiction to decree return of the deposit. The Circuit did not agree, and held [340] :

"Assuming without holding that the Bankruptcy Court, of its own motion, or on that of an interested party, would have been without jurisdiction in a summary action to order a return of the \$3,000 deposit, Floro having submitted to the court its claim for possession of the property involved, brought to the court for determination not only the questions which it deemed germane to its right of possession but also all questions of defense which would be lawfully interposed, and cannot thereafter withdraw, but that court has jurisdiction thereupon to determine all controversies in relation to the claim thus submitted."

In so holding the Court relied upon determinations in the Second Circuit, and upon *Florance vs. Kresge, supra*, which the Eighth Circuit quotes [341] at some length with approval, so referring to and adopting the *Florance vs.*

Kresge interpretation of Hillman. While recognizing factual differences in the cases, the Court further quoted the statement from *Case vs. Los Angeles Lumber Co.*, 308 U.S. 106, 126, 127, 60 S.Ct. 1, 12, 84 L.Ed. 110 [341]:

"And once the jurisdiction of the court has been invoked, whether by the debtor or by a creditor, that petitioner cannot withdraw and oust the court of jurisdiction. He invokes that jurisdiction risking all of the disadvantages which may flow to him as a consequence, as well as gaining all of the benefits."

The Court mentions that there have been other authorities cited to it by the claimant-appellant, "but almost, if not all of them, are cases where the property involved was in the possession of an adverse claimant who was not seeking relief from the bankruptcy court, and had not submitted to the court's jurisdiction, and none in point here."

Moreover, the Court states [341] that objection to the jurisdiction at the time the bankruptcy court is asked to pass on the counterclaim, and after the claimant has itself invoked the jurisdiction by the filing of its claim, comes too late:

"It is true that when the bankruptcy court was asked to pass upon the question of the return of the \$3,000 deposit, Floro objected to the court doing so in a summary action, but that objection came too late, as it had already invoked the jurisdiction of the bankruptcy court and could not then withdraw, and no new consent on its part was necessary."

Precisely the same situation exists at bar. Petitioner sought to recover on claims. When counterclaims were as-

serted, he objected to the exercise of the plenary jurisdiction he had himself invoked and put in motion. "That objection came too late."

5. IN THE NINTH CIRCUIT.

Peters et al. vs. Lines, Trustee, (CCA 9th, 1960), 275 F.2d 919, involved a proceeding on a petition by the trustee in bankruptcy for affirmative relief against creditors based on an alleged breach of contract by those creditors, operating logging mills, and the bankrupt, a supplier of logs. The Ninth Circuit held that where the creditors had filed claims against the bankrupt based on alleged breach of contract by the bankrupt, the bankruptcy court thereby acquired jurisdiction to grant affirmative judgment against the creditors, in summary proceedings based on transactions arising out of the contracts. There arose some questions on the amount of damages, discussed at length in the opinion and not here germane.

Essentially, the Court held that the creditor, by filing proof of claim against the bankrupt, consented to the jurisdiction of the bankruptcy court to render an affirmative judgment against the creditor on trustees counterclaims arising out of the same contract. The Court held against the contention that the plenary suit was the only method of recovery on the counterclaim, since it pointed out that the purpose of a plenary suit in bankruptcy administration is to seek recovery from a person who has not voluntarily submitted himself to the jurisdiction of the bankruptcy court, and that, obviously, if a person, not compelled to come into the bankruptcy court, does so for his own advantage, as in the presentation of a claim, then a plenary suit against him is purposeless, since he has of his own voli-

tion submitted his claims and whatever counterclaims arise therefrom to the summary jurisdiction of the bankruptcy court, has consented to the summary jurisdiction and disposition, and has waived any right to jury trial.

Deciding the case, the Court asked itself the question [923]: "Did the bankruptcy court have summary jurisdiction not only to hear but to grant the trustee's petition for affirmative relief against appellants?" It held that that question "must be answered in the affirmative." [924].

In so holding it directly holds against Petitioner's contention that there is no statute granting jurisdiction, citing Section 2, sub. a(7) and Section 68 of the Bankruptcy Act, Title 11 USCA #11, sub a(7) and 108.

The Court points out that there is no clear decision in the Ninth Circuit upon the jurisdictional question, and so discusses, and summarizes rather interestingly, the positions of the several circuits in this regard [924-5]:

" * * * The other circuits are not entirely in accord on this question, although the apparent conflict can be reconciled. The leading case supporting the summary jurisdiction of the bankruptcy court in such a case as this is *Florance vs. Kresge*, 4 Cir., 1938, 93 F.2d 784, the principle of which was re-affirmed in *Columbia Foundry Co. vs. Lochner*, 4 Cir., 1950, 179 F.2d 630, 14 A.L.R.2d 1349, and more recently in *Continental Casualty Co. vs. White*, 4 Cir., 1959, 269 F.2d 213. The rule in the Fourth Circuit is thus clearly defined that the claimant, by submitting his claim to the trustee in bankruptcy, consents to the summary jurisdiction of the bankruptcy court to administer a counterclaim against the claimant asserted by the trustee *provided* the subject matter of the counter-

claim is the same as that of the original claim. This is also the rule of the Second Circuit, Chase National Bank vs. Lyford, 2 Cr., 1945, 147 F.2d 273; the Third Circuit, In Re Solar Mfg. Corp., 3 Cir., 1952, 200 F.2d 327, certiorari denied sub nom. Marine Midland Trust Co. vs. McGirl, 345 U.S. 940, 73 S.Ct. 831, 97 L.E. 1366; The Eighth Circuit, Floro Realty & Investment Co. vs. Steem Electric Corp., 8 Cir., 1942, 128 F.2d 338; and the Tenth Circuit, Interstate National Bank vs. Luther, 10 Cir., 1955, 221 F.2d 382. Thus five circuits are of the view that the filing of a claim is an implied consent to the bankruptcy court's summary jurisdiction of a counterclaim arising from the same transaction as that from which the proof of claim arises.

"In the case of B. F. Avery & Sons vs. Davis, 5 Cir., 1951, 192 F.2d 255, certiorari denied 1952, 342 U.S. 945, 72 S.Ct., 559, 96 L.Ed. 703, the Fifth Circuit held that a claimant did not, merely by filing his proof of claim against a bankrupt estate, submit himself to the summary jurisdiction of the referee to recover a preference against him which did not arise out of the same transaction as that involved in the claim. Hence, the Avery Case is distinguishable on its facts from the line of decisions following the leading case of Florance vs. Kresge, *supra*, although it is often cited as holding directly contrary to them. To hold that the filing of a proof of claim is to submit to the summary jurisdiction on a counterclaim arising from the same transaction is quite a different matter from holding that submission of a claim is a consent to summary jurisdiction on a counterclaim arising from an entirely separate transaction."

It is abundantly clear, then, as summarized by the Court, that the clear preponderance of decided authority follows the rule of *Florance vs. Kresge* and its interpretation of *Hillman*; that that rule, followed by the Tenth Circuit in the case at bar, is the uniform current of authority, and the established authority in six Circuits; and that the claimed "contrary" authority is in essence not contrary at all, but is predicated upon the distinction between a counterclaim which arises out of the same transaction or circumstance or event as the claim conferring jurisdiction, and a counterclaim which arises out of an entirely different and separate transaction. This distinction is recognized as inhereing in the cases claimed by Petitioner to support his position.

At page 9 of the Brief, Petitioner attempts to set forth some such support. He mentions *Avery vs. Davis*, discussed by the Ninth Circuit above, and effectively concedes the distinction, namely that the claims disallowed arose out of different transactions. He mentions the decision of the Seventh Circuit in *In Re Majestic Radio*, (CCA 7th, 1955) 227 F.2d 152. That decision, however, is fully discussed by the Ninth Circuit in *Peters vs. Lines*, [925, note 4], where the Court notes that the distinction between consent to jurisdiction of a counterclaim arising out of the same transaction and to one arising from an entirely separate transaction has been well noted by the 7th Circuit, and quotes from *Majestic Radio, supra*, 156:

"But no case has been cited, nor have we found any, in which it has been held that a Bankruptcy Court has acquired such jurisdiction of a setoff or counter-claim because the counterdefendant had filed a proof of claim arising out of a completely different subject matter."

Though the Petitioner cites [Brief, page 9], *Continental Casualty vs. White*, in *Re Solar Manufacturing Corp.*, and *Peters vs. Lines*, all *supra*, not one of those cases holds in his favor, but, as discussed at length, holds diametrically in opposition, in the most explicit terms, to his position, while as pointed out in *Peters vs. Lines*, the two cases which hold differently, *Avery vs. Davis* in the Fifth Circuit and *Majestic Radio*, in the Seventh, are expressly distinguished in the opinions, involving counterclaims arising from transactions different from those giving rise to the claim upon which jurisdiction is predicated.

This distinction is fully recognized by the Tenth Circuit in the opinion at bar, the counterclaims based upon the failure to pay stock subscriptions being disallowed by the Circuit Court. As pointed out in the Opinion below [Record, page 9], this distinction is recognized by the Respondents, and the Tenth Circuit states [Record, page 11]:

“Upon reconsideration of *Inter-State*, in the light of subsequent decisions and commentary, we have decided to adhere to its pronouncements. But, we decline to extend the summary jurisdiction of the court by implied consent to counterclaims which do not involve a preference, set-off, voidable lien, or fraudulent transfer, and which are wholly unrelated to the creditor’s claim. Claims of this nature are not within the Referee’s summary jurisdiction, and a claimant does not consent to the exercise of the bankruptcy court’s plenary jurisdiction by filing his claim in bankruptcy.” Accordingly, “the judgment of the bankruptcy court is affirmed on all counterclaims except the Trustee’s

counterclaim for the purchase price of the subscription stock."

It would then appear, as it is respectfully submitted, that there does not exist in the Circuits authority for the present position of Petitioner; that the counterclaims, being preference claims intimately related to the subject matter of the Petitioner's claim, consent to the summary jurisdiction was given by filing of the claims, and full jurisdiction existed in the Referee and Bankruptcy Court to grant affirmative relief upon those counterclaims allowed.

At Page 11 of the Brief, we submit, Petitioner effectively concedes his case. The rationale of the entire developed line of cases, as summarized above, rests upon the fact that jurisdiction in bankruptcy having attached, it is the fundamental function of and requirement incumbent upon the Referee and Bankruptcy Court to make full and complete disposition of the assets of the bankrupt estate and of the claims against it. *Hillman* states the principle of full determination in equity. *Kresge* and the succeeding line of cases apply the principles to bankruptcy. The Tenth Circuit in *Interstate*, as discussed both above and hereinafter, recognizes the structural integrity of the bankruptcy system as created by the statutes referred above, and specifically including the process granted and duties imposed by 57(g).. Not only, then, is there no absence of statutory authority, but the statutes make it incumbent upon the Referee to adjudicate and finally determine claims, which is possible only if he adjudicates as well related counterclaims which involve preference, set-off, voidable lien, or fraudulent transfer. This is the essence of *Interstate vs. Luther*, and of the majority

opinion below and here sought to be reviewed, and is the quintessence of Bankruptcy jurisdiction, for otherwise the administration in bankruptcy must become mired in a morass of circular litigation.

6. IN THE TENTH CIRCUIT

The Tenth Circuit has, of course, followed the position basically detailed above. That Court first considered the problem in *Inter-State National Bank of Kansas City vs. Luther*, Trustee, (CCA 10th, 1955) 221 F.2d 382, in which certiorari was granted by this Court, but the proceeding later dismissed upon agreement of the parties.

Proceedings were in bankruptcy. A creditor filed proof of claim, and the trustee sought affirmative relief. The referee voided a preference and directed that the trustee recover from the creditor, who appealed. The District Court sustained the Referee, and the Circuit Court sustained the District Court, two judges dissenting.

Essentially the Court held that although a bankruptcy court cannot within the summary jurisdiction adjudicate a controversy respecting property held adversely to the bankrupt estate without consent of the adverse claimant, where a creditor files proof of a claim, and responsively the trustee seeks relief against that creditor, the effect is that of an equitable counterclaim, of which the Court does have jurisdiction, and the 1952 Amendment to the Bankruptcy act was not intended to either extend the summary jurisdiction or to extinguish it once attached, but was purposed to apply only to controversies arising in bankruptcy where the adverse party is brought into court by preemptory process, and not where the claimant himself voluntarily comes into court seeking relief under

the summary jurisdiction. Accordingly, when once the jurisdiction in bankruptcy has been invoked, the person so invoking jurisdiction risks all disadvantages which may flow to him as well as gaining all benefits derivative from invocation of the jurisdiction.

Judge Murrah, who wrote the opinion sought here to be reviewed, also wrote the opinion in *Luther*. He considered all of the cases cited above which had been decided to the time of *Luther*, and considered also and quite fully the line of opinions relied upon by the Petitioner here. The Court considered very fully [388-389] the effects of *Hillman*, and reviewed earlier decisions in other circuits, reviewed *in extenso* above, applying the *Hillman* doctrine to bankruptcy proceedings, concluding [389]:

"It is only a short, and to us a perfectly valid jurisdictional step from the summary power to adjudicate a voidable preference and summary power to grant affirmative relief thereon, especially when the authorized adjudication has binding effect in a plenary suit. Certainly the exercise of this affirmative equitable jurisdiction is within the substantive provisions of the Bankruptcy Act providing for the disallowance of claims tainted with a preference, i.e. see #57 sub. g. and 60, sub. a., *supra*."

In *Luther*, the Court apparently further held that Bankruptcy Act provisions authorizing set-off of all mutual debts and credits between the bankrupt estate and the creditor imported equity set-off into bankruptcy, and so indicated that there might be use of the summary jurisdiction with relation to claims which did not arise out of the same transaction as the claim upon the filing of which consent to jurisdiction is pre-

dicated. No such problem, as a problem of fact, is presented at bar, and, as noted above, the Tenth Circuit in the opinion here under consideration [quoted at page 34 above], has declined to extend the summary jurisdiction of the court by implied consent to counter-claims which do not involve a preference, set-off, voidable lien, or fraudulent transfer, and which are wholly unrelated to the creditor's claim, holding claims of this nature not within the summary jurisdiction, and that a claimant does not consent to the summary jurisdiction over such claims by filing his claim in bankruptcy. As mentioned, this position is agreed to by the Respondent, and the three counterclaims allowed are entirely within the class over which jurisdiction is held to exist.

The further development by the Tenth Circuit has taken place in the opinion in this Case, which is fully printed, both as to the majority, concurring, and dissenting opinions, in the Transcript of Record [pages 8 and following], being reported in 336 F.2d 535.

It is respectfully submitted that the determination of the Tenth Circuit, as announced in the majority opinion below, is entirely consonant with the full range of judicial thinking since *Hillman*, as concerns the bankruptcy jurisdiction, and is predicated specifically upon well considered and thoroughly documented opinions from five other circuits, the full majority of the Circuits adhering to the position expressed below, and, as explained above, contrary opinions in the Fifth and Seventh Circuits being entirely reconcilable upon the predicate of the facts in those cases involving claims not related to or arising out of the same transaction as the claim predicated as the jurisdictional basis.

C. THE LINE OF DECISIONS DEVELOPED AS DETAILED ABOVE IS GENERALLY APPROVED BY COMMENTATORS UPON BANKRUPTCY LAW UPON THE BASES THAT "EQUITY ONCE INVOKED WILL ACHIEVE COMPLETE RELIEF", AND FURTHER THAT SOUND CONSTRUCTION OF THE BANKRUPTCY ACT WARRANTS A COMPLETE ADJUDICATION.

In *Columbia Foundry vs. Lochner*, *In Re Solar Manufacturing Corporation*, and the Majority Opinion below, reference is made to the adoption of the essential view expressed in the digested cases by the editor of Collier on Bankruptcy [Vol. 4, pp. 788-790], an authority of obviously high reputability in this field of the law.

The quoted work states, as set out in *Lochner, supra*, states:

"It is clear that where the plaintiff's petition is of such a nature that he submits his cause to the bankruptcy court, and manifests a willingness that the court fully determine his rights therein, such as in a reclamation petition, he consents to the court's jurisdiction and cannot complain thereafter of the Court's power to render a judgment against him upon a proper setoff or counterclaim asserted by the trustee. On the other hand, the mere filing of a proof of claim for allowance is not such a clear expression of consent, and that a bankruptcy court may not render an affirmative judgment upon a set-off or counterclaim asserted by the trustee. It was said that a plenary suit was the only remedy, unless the trustee waived all right to the excess. In *Florance vs. Kresge*,

however, the court held that the filing of an unsecured claim amounted to a submission to the court's jurisdiction so as to permit an affirmative judgment upon a proper counterclaim asserted by the trustee and receivers. In the light of expeditious administration of bankruptcy estate, and an avoidance of multiplicity of litigation, this decision has much to recommend it. It would further serve to reduce the operation of the 'absurdity of making A pay B when B owes A.'

"One who files a proof of claim should be held to acquiesce in the adjudication of any proper set-off or counterclaim even to the extent of a judgment thereon, since as pointed out in the Kresge case, the claimant puts himself in a position, should his interests warrant, to challenge the receiver's or trustee's acts and the demands of others claiming as creditors. He should not be permitted to claim the benefits of such a position, and yet maintain a favored advantage as against the trustee or receiver, compelling that officer to resort to a plenary action to collect on a claim that is a proper subject of set-off or counterclaim."

The majority opinion below also adverts to an article by Professor Moore, editor of *Collier*, in 68 *Yale L.J.* 1, 32, quoted in the footnote [Record, pages 10-11 herein] wherein Professor Moore agrees with the majority in *Interstate* and below upon the basis that under the doctrine of *Hillman*, equity once invoked will grant complete relief, and that, practically, sound construction of the *Bankruptcy Act* warrants complete adjudication. Indeed, if this is not the case, then *Bankruptcy jurisdiction* must become utterly chaotic, and the speed and expedition which is its essence as a constructive force must be entirely lost and foregone.

The view which is contended for by the Respondent and expressed above seems to find acceptance so general at present that a subversion of it would be effectively a basic denigration of bankruptcy jurisdiction. Thus, the position finds quite unequivocal statement even in the encyclopedic writings, as for example 9 Am. Jur. 2d 402, Bankruptcy #520, where it is basically stated:

"A number of decisions recognize jurisdiction in the bankruptcy court, when a counterclaim comes before it in opposition to a claim proved in bankruptcy proceedings, to render affirmative judgment on the counterclaim against the original claimant in such amount as the counterclaim may be established in excess of the established amount of his claim. This view seems to be clearly sound where the counterclaim arises out of the same transaction on which the claim is based and is accordingly in the nature of a defense by way of recoupment, even though the creditor who filed the claim is a nonresident of the district, as, by filing proof of claim, the creditor is deemed to consent to jurisdiction of the bankruptcy court to adjudicate all aspects of any controversy pertaining to it. The propriety of entering an affirmative judgment against the original claimant in such instances, if the counterclaim is found to be valid in an amount exceeding his allowable claim, is now sustained in at least six circuits. [Emphasis supplied]. The counterclaim must, however, be one arising out of the same transaction and in the nature of recoupment, or one based on mutual debts or credits and within the orbit of Bankruptcy Act #68, in order to serve as a basis for affirmative judgment by the bankruptcy court against the original claimant, since, with respect to other con-

tested liabilities, he is an adverse claimant entitled to plenary suit and is not deemed to invite or consent to exercise of bankruptcy court jurisdiction by merely filing proof of claim against the estate."

D. NO MERIT INHERES IN THE CONTENTION THAT ADJUDICATION OF COUNTERCLAIMS ARISING FROM THE SUBJECT MATTER OF A CLAIM FILED IN BANKRUPTCY DEPRIVES THE CLAIMANT OF ANY RIGHT UNDER THE SEVENTH AMENDMENT GUARANTY OF JURY TRIAL.

Petitioner contends that, inasmuch as he cannot have a trial by jury upon the counterclaims arising out of and adjudicated in connection with his claims or the subject matter thereof, he is deprived of a right guaranteed him by the Seventh Amendment to the Constitution.

None will detract from the importance of jury trial, but neither should there be interference upon such predicate with jurisdiction never within the contemplation or scope of that guaranty.

The Seventh Amendment simply provides that "*in suits at common law*, where the value in controversy shall exceed twenty dollars, the right to trial by jury shall be preserved." [Emphasis supplied].

Bankruptcy jurisdiction is *not common law jurisdiction*. Claims filed in bankruptcy and the counterclaims dependent thereon and related to the subject matter thereof are not claims at common law and do not involve in their adjudication suits at common law.

It is to be remembered that the power to legislate on the subject of bankruptcies is expressly conferred upon the Congress of the United States by the Constitution itself, Article I, Section 8, Clause 4, providing that Congress shall have the power "to establish . . . uniform laws on the subject of bankruptcies throughout the United States." Moreover, Congress in this respect has the general power "to make all laws which shall be necessary and proper for carrying into Execution the foregoing powers."

Obviously bankruptcy is an ancient jurisdiction, having been well known to the authors of the Constitution, and deriving in formal form from the first English Bankruptcy Act of 1542, during the reign of Henry VIII, and derivatively from nearly three centuries of English law, itself stemming from Roman commercial precedent. *Continental Illinois Bank & Trust Co. vs. Chicago, R. I., & P. R. Co.*, 294 U.S. 648, 79 L.Ed. 1110, 55 S.Ct. 595.

Though historically connected with the English law, bankruptcy as we know it does not wholly parallel the English theory, which was partially criminal in nature, primarily conceived to deal with fraudulent debtors, and intended to distribute the sought-out properties of such persons among their creditors, while the modern concept of bankruptcy has been extended to relieve the embarrassed and "honest" debtor by discharge, perhaps one of the most important of the bankruptcy functions, to conserve the estate of the debtor in order to maximize and equalize distribution, and even to reorganize the estate in order to preserve the economy from the shock of substantial and total commercial failures.

It is rather obvious that such a jurisdiction is not fundamentally a common law jurisdiction. Indeed, under the classic theory of the common law, "the race is to the swift", and the creditor who first obtains adjudication of his claim and by legal processes seizes an asset is entitled to the benefit thereof, while bankruptcy, quite opposingly, fundamentally seeks a marshalling and a non-preferential distribution.

The jury has always been a bulwark of the common law adjudication of basic and controverted issues of fact. Its utility is recognizedly limited in complex matters of accounting, and inutile to the point of disallowance in general *equity* cognizance.

Because of the broad, broadening, and basic function the bankruptcy jurisdiction plays in American economics, this Court has tended, and the tendency of both legislative and judicial interpretation of the bankruptcy powers has been, uniformly in the direction of a liberalization of the scope of the bankruptcy jurisdiction conferred upon the Congress by the Constitution, and not upon a limitation of that jurisdiction by procedural impediments such as the universal introduction of jury trial. *Continental Illinois*, *supra*, rather elaborately indicates this tendency, and indicates that the limitations upon the power of the Congress to legislate upon the subject of bankruptcies is an area never explicitly defined, while the full width of boundary of the field has not yet been revealed.

The real scope of the power of the Congress is the "subject of bankruptcies", and, of course, there can be no final definition, since the scope continually changes with the alterations in the economy. *Wright vs. Union Cent. L.*

Ins. Co., 304 U.S. 502, 82 L.Ed. 1490, 58 S.Ct. 1025, rehearing denied 305 U.S. 668, 83 L.Ed. 433, 434, 59 S.Ct. 56. Accordingly, and in the same case, it is stated that the power of the Congress over bankruptcies is certainly not limited to the extent of English bankruptcy jurisdiction at the time of the adoption of the Constitution, while the grant of the power of Congress in this, as in other fields of a living constitution, is not restricted to the grant as utile and understood at the time of adoption of the Constitution under the conditions then existing, but must be interpreted under modern conditions in order to deal adequately with the ever more complex relationships existing between financially embarrassed debtors and their creditors and even the policy itself.

Several of the Circuits, in the decisions adverted to above, have expressly—and negatively—considered the permissible role of the jury in adjudication of counter-claims of the kind here involved.

Thus, *Columbia Foundry Co. vs. Lochner*, *supra*, specifically holds that bankruptcy courts in dealing with the claims of creditors sit as courts of equity and try such claims without the intervention of a jury, citing in this regard *Pepper vs. Litton*, 308 U.S. 295, 303-311, *In Re International Power Securities Corp.* (CCA 3rd) 170 F.2d 399, 402; *In Re Kansas City Journal-Post Co.* (CCA 8th) 144 F.2d 791, 800, and *In Re Commonwealth Light and Power Co.*, (CCA 7th) 141 F.2d 734, 736.

In *Peters vs. Lines*, *supra*, the Ninth Circuit holds explicitly that the creditor by filing a proof of claim in bankruptcy consents to the summary jurisdiction of the bankruptcy court and waived any right to trial by jury to any of the issues involved, saying [927]:

" * * * We are not impressed by appellant's argument that they were denied their right to a jury trial. In view of the record on this point, such contention is far more illusory than real. In filing their proof of claim in the bankruptcy court appellants consented to the summary jurisdiction of the bankruptcy court and thereby waived any right to trial by jury on the issues involved in such claim. * * * "

Petitioner claims the loss of the same "right" to a jury trial, but of course had no such "right" and is nowhere guaranteed it, expressly or impliedly. The "right" is one to trial by jury "IN SUITS AT COMMON LAW". Bankruptcy does not operate within and is not derivative from the common law. It is principle diametrically opposed to the basic common law doctrines of judgment and execution and priority of time in lien and in right. It is historically non-derivative from common-law sources. It is in a manner of speaking *sui generis*, and the subject of explicit, ample, and broadly interpreted grant of power to the Congress, which has seen fit only in a few and isolated aspects of this many-faceted jurisdiction to authorize jury trial, a process inherently inapplicable to the equitable and accounting problems with which the jurisdiction is primarily designed to cope.

This Court has sometimes referred to the bankruptcy courts as courts of Equity, as in *Continental Illinois National Bank & Trust Co., supra*, *Local Loan Co. vs. Hunt*, 292 U.S. 234, 78 L.Ed 1230, 54 S.Ct. 695, 93 ALR 195; *Bardes vs. First Nat. Bank*, 178 U.S. 524, 44 L.Ed 1175, 20 S.Ct. 1000; and *Stucky vs. Masonic Saving Bank*, 108 U.S. 74, 27 L.Ed 64, 2 S.Ct. 219. In *Young vs. Higbee Co.*, 324 U.S. 204, 89 L.Ed 890, 65 S.Ct. 694, this Court con-

sidered the bankruptcy courts as courts of equity exercising all equitable powers unless prohibited therefrom by the Bankruptcy Act, while in *Pepper vs. Litton*, 308 U.S. 295, 84 L.Ed 281, 60 S.Ct. 218, this Court considered the bankruptcy courts to be courts of equity at least in the sense that these courts in the exercise of the jurisdiction conferred upon them by the Act apply principles and rules of equity jurisprudence, invoking equitable powers to the end that fraud will not prevail, that substance will not give way to form, and that technical considerations will not foreclose the doing of justice.

In *SEC vs. United States Realty & Improvement Co.*, 310 U.S. 434, 84 L.Ed 1293, 60 S.Ct. 1044, this Court pointed out that the bankruptcy courts might consider the public interest, exercising its power or staying its hand, in an equitable manner, when it reasonably appears that public rights will not suffer thereby.

Many other decisions, both of this Court and in the circuits, emphasize the rights, powers, and duties of the bankruptcy court, in its equitable jurisdiction, to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in the administration of a bankrupt estate, and most of the decisions emphasize the complexity of the problems dealt with and the need, as stated in *Hillman*, to deal with them whole, non-circumlocutiously, and ultimately and finally, not piecemeal and protractedly.

The Act itself explicitly gives to the bankruptcy courts jurisdiction at law and in equity such as to permit them to exercise the original jurisdiction in proceedings under the Act, and the Act was pioneering in allowing in a single action administration of all available types of relief.

Amalgamating the decisions, it is quite clear that bankruptcy is not in the category of "suits at common law", though certainly it, as a court of equity, may not ignore the common law or common law rights. In procedural essence bankruptcy is differently polarized than the common law, generally proceeding in accordance with equitable principles, and really constituting a special, constitutional, and statutory branch of law, jurisdiction, and jurisprudence, which is not even remotely describable in the term "suits at common law" as used in the Seventh Amendment, and is something existing in parallel with and separate and distinct from the common law.

Historically, the jury has no role in bankruptcy claim determinations, and could not have been understood to have such a role, as of mandatory right, when the Bill of Rights and the included Seventh Amendment were adopted, and there is no right to "preserve".

Basically, the doctrines of claim and set-off, allowance of and judgment upon related counterclaim is an equitable doctrine of justice and convenience deriving from the maximal notion of complete adjudication of any controversy once submitted to a jurisdiction having power of cognizance.

Fundamentally, equal distribution of assets among creditors, not considering point of time or of execution, but proceeding upon a kind of principle of marshalling is clearly of equitable origin, and claim to participation therein, subject to duty of account on counterclaims, is a submission to equity jurisdiction, in which the right of jury never inhered, and operable upon bases in which jury utility does not exist.

Neither historically, nor in point of reason, nor in point of practicality of approach to the bankruptcy jurisdiction as defined by this Court does the jury have a role in proceedings of the kind at bar. Neither in words nor in principle does or should the Seventh Amendment apply.

CONCLUSION:

In conclusion, then, it is most respectfully submitted that the determination below is correct, and should be sustained.

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